GOVERNOR'S OFFICE OF BUDGET AND PROGRAM PLANNING

Fiscal Note 2011 Biennium

Bill #	HB0651		**Title:**	Generally revising laws related to taxation
Primary Sponsor:	Cohenour, Jill		**Status:**	As Introduced

- ☐ Significant Local Gov Impact
- ☐ Needs to be included in HB 2
- ☑ Technical Concerns
- ☐ Included in the Executive Budget
- ☐ Significant Long-Term Impacts
- ☐ Dedicated Revenue Form Attached

FISCAL SUMMARY

	FY 2010 Difference	FY 2011 Difference	FY 2012 Difference	FY 2013 Difference
Expenditures:				
General Fund	$0	$0	$0	$0
Revenue:				
General Fund	$2,115,000	$4,365,000	$3,974,000	$3,461,000
State Special Revenue	$0	$63,000	$32,000	$0
Net Impact-General Fund Balance:	$2,115,000	$4,365,000	$3,974,000	$3,461,000

Description of fiscal impact:

This bill has three provisions with fiscal impact:

- Provides the Department of Revenue with additional tools for identifying taxpayers who have participated in abusive tax avoidance transactions and for bringing them into compliance
- Requires additional justification for the amount of property taxes protested by owners of centrally assessed property; this will not change the amount of property taxes ultimately paid, but will accelerate revenue collections in FY 2011 and FY 2012
- Increases the statute of limitations for corporation license tax from 3 years to 5 years, allowing the department to audit more years of a taxpayer's back returns

Together, these provisions will increase general fund revenue by about $2.1 million in FY 2010, $4.4 million in FY 2011, $4.0 million in FY 2012, and $3.5 million in FY 2013 and later years.

FISCAL ANALYSIS

Assumptions:

1. This bill has two types of provisions that will affect state and local revenue.
    a. Sections 1 through 10, 14, and 15 will increase revenue from income tax and corporation tax compliance activities. Additional revenue from these provisions will vary significantly from one

year to the next. For this reason, this fiscal note provides an estimate of the minimum revenue increase that can reliably be expected each year from the compliance-related provisions of this bill.

b. Sections 11 through 13 make changes to the procedure for property tax protests by owners of centrally assessed property. These provisions are not expected to change the amount of taxes ultimately paid on centrally assessed property; rather, they are expected to reduce the amount of taxes that are protested and temporarily deposited in county and state protest accounts. This will accelerate the deposit of tax revenue to the general fund, university system special revenue fund, and local funds, which will increase revenue recorded to these funds for approximately two years.

Abusive Tax Avoidance Transactions: Increased Reporting Requirements and Penalties

2. Federal law requires the IRS to list potentially abusive tax avoidance transaction and requires taxpayers and tax advisers who participate in such transactions to file one or more forms with the IRS disclosing this fact. This bill would require taxpayers to report their participation in an abusive tax avoidance transaction to the Department of Revenue (DOR) and would provide substantial penalties for taxpayers who fail to report.
3. This bill would require a multi-state corporation to report any inconsistencies between its Montana tax return and a return it files with another state. It also requires a corporation to file an amended return if an audit by another state affects the corporation's Montana tax liability.
4. Over the last three years, DOR has averaged $0.4 million in additional compliance revenue from taxpayers that the department identified from outside information as having participated in potentially abusive tax avoidance transactions. The reporting requirements in this bill will provide the department another tool to identify these types of taxpayers. The department expects this to increase annual audit revenue related to abusive tax avoidance transactions by at least $0.5 million per year, with $1.0 million in FY 2010 due to additional taxes from back years.
5. Section 8 requires corporations to disclose inconsistencies between their Montana returns and returns filed with other states. Audit adjustments based on reconciling such differences may be large, but are not expected every year.
6. Sections 3 through 5 provide penalties for understatement of income or overstatement of credits using an abusive tax avoidance transaction and for failure to provide required information related to transactions that must be reported to the IRS. Based on penalties the department could have assessed in the last three years if this bill had been in effect, additional penalties are expected to be at least $0.5 million per year.

Other Reporting Requirements and Penalties

7. Section 10 provides a penalty for substantial understatement of income or corporation tax similar to Section 6662(d) of the IRS code. These provisions would have allowed the department to impose a number of significant penalties in the last several years. Other states and the IRS often waive these penalties for taxpayers who cooperate and bring themselves into compliance; if the department follows this practice, these penalty provisions would rarely produce significant additional revenue.

Statute of Limitations

8. Under current law, DOR may audit a corporation license tax return and assess additional tax on returns that were filed within the last three years or that are being audited by the IRS. The same three year limit applies to consolidated returns of S-corporations, which essentially limits the department to auditing three years of individual income tax returns for shareholders of an S-corporation even though the individual income tax statute of limitations is five years. This bill would allow the department to audit returns and assess additional tax on returns that were filed in the last five years or are being audited by the IRS.
9. In FY 2007 and FY 2008, the department collected additional revenue or reduced refunds from an average of 23 field audits per year. On average, these audits covered returns from 3.4 years, and audit revenue averaged $160,525 for each year's return being audited.
10. Adding an additional two years of returns to 23 field audits per year would result in $7.384 million in additional revenue (23 audits x 2 years x $160,525). There would be no additional revenue from audits where more than three years of returns are being audited by the IRS. Also, with individual audits covering

more years and no increase in audit staff, the department might average fewer field audits each year, and corporations would have an additional two years to file amended returns and ask for a refund. Thus, the additional revenue is estimated to be one-third this amount, or $2.461 million.

11. This bill would be effective on passage and approval, affecting audits being conducted from the spring of 2009 forward. Because of the time between the beginning of an audit and when a taxpayer pays any resulting assessment, the increase in revenue is estimated to be 25% of the projected annual amount, or $0.615 million, in FY 2010 and 95% of the projected amount, or $2.338 million, in FY 2011.

Centrally Assessed Property Tax Protests

12. When the owner of centrally assessed property pays taxes under protest, the county treasurer is required to send the share of those taxes due to the 95 mill school levy and the 6 mill university levy to the state. Half the protested amount is deposited in protested property tax special revenue funds and half it deposited in the general fund and the university system special revenue fund. When the protest process is completed, any refund due the taxpayer is paid from the protested property tax funds.
13. DOR reviewed a sample of protests of property taxes on centrally assessed property since 2000. In these cases, the taxpayers had protested more than 25% of the taxes assessed and were ultimately determined to owe more than 85% of the amount protested.
14. Section 11 would require any owner of centrally assessed property that protests property taxes totaling more than $100,000 statewide to provide an independent appraisal of the property with the protest. Sections 12 and 13 would make appraisals where the appraiser's fee is conditional on a pre-determined value or outcome inadmissible before the State Tax Appeals Board.
15. The provisions of Sections 11 through 13 are not expected to change the amount of property tax ultimately paid on centrally assessed property, but they are expected to reduce the amount of taxes paid under protest. This will reduce the amount that is temporarily held in protest accounts.
16. The HJR 2 property tax revenue estimate assumes that $3.080 million will be deposited in the 95 mill protested property tax account each year and $0.190 million will be deposited in the 6 mill protested property tax account each year. HJR 2 does not make an explicit assumption about the amount that is paid out of the protest fund each year as refunds and as transfers to the general fund and the university system.
17. Under current law, on average, 15% of taxes protested are refunded (see Assumption 13). Since half of protested taxes are deposited in the protest funds, current law refunds each year will be 30% of deposits. Thus, current law refunds from the 95 mill protest fund will be $0.924 million per year (30% x $3.080 million), and current law refunds from the 6 mill protest fund will be $0.057 million per year (30% x $0.930 million). Current law transfers to the general fund will be $2.156 million (70% x $3.080 million), and current law transfers to the university system will be $0.133 million (70% x $0.190 million).
18. Owners of centrally assessed property will reduce their protests after a year of experience with the new requirements. Beginning in FY 2011, this bill will reduce protests of centrally assessed property by one-third but will leave the amount of refunds from the protest funds due to successful protests unchanged. This will accelerate payments to the general fund and the university system, resulting in higher revenue for a transition period where payments out of the protest fund are still from protests at their current law level. Assuming that the protests brought to conclusion each year are from the previous two years, this transition period will last for two years.
19. The following table shows the changes in the flow of funds through the 95 mill protest fund. The row for FY 2009 shows revenue flows before the change proposed by this law. Under current law, each of the later years would be the same as FY 2009. With this bill, in FY 2011 and later years, deposits to the protest fund would drop to $2.053 million, while refunds from the account would remain unchanged at $0.924 million. Initial deposits of property taxes to the general fund would increase by the $1.047 million no longer being deposited in the protest fund. In FY 2011, transfers from the protest fund to the general fund would still be $2.156 million, based on the old level of protests, and there would be a net increase of $1.027 million to the general fund. In FY 2012, half of the funds transferred from the protest fund to the general fund would be from protests made at the old, higher percentage, and half would be from protests

made after this bill went into effect. There would be a net increase of $0.513 million in deposits to the general fund. In FY 2013 and later years, initial deposits of property tax revenue to the general fund would be $1.047 million higher and transfers from the protest fund to the general fund would be $1.047 million lower, both because of the smaller protests.

Change in Flow of Funds Through 95 Mill Protested Property Tax Fund ($ million)					
Fiscal Year	Deposits to Protest Fund	Refunds	Change in Initial Deposits to General Fund	Transfers, Protest Fund to General Fund	Change, Revenue to General Fund
2009	$3.080	$0.924	$0.020	$2.156	
2010	$3.080	$0.924	$0.020	$2.156	$0.000
2011	$2.053	$0.924	$1.047	$2.156	$1.027
2012	$2.053	$0.924	$1.047	$1.643	$0.513
2013	$2.053	$0.924	$1.047	$1.129	$0.000

20. The following table shows the changes in the flow of funds through the 6 mill protest account:

Change in Flow of Funds Through 6 Mill Protested Property Tax Fund ($ million)					
Fiscal Year	Deposits to Protest Fund	Refunds	Change in Initial Deposits to U-System	Transfers, Protest Fund to U-System	Change, Revenue to U System
2009	$0.190	$0.057	$0.000	$0.133	$0.000
2010	$0.190	$0.057	$0.000	$0.133	$0.000
2011	$0.127	$0.057	$0.063	$0.133	$0.063
2012	$0.127	$0.057	$0.063	$0.101	$0.032
2013	$0.127	$0.057	$0.063	$0.070	$0.000

Administrative costs

21. The additional penalty provisions of this bill would require changes to the Department of Revenue's data processing system. These changes would require 200 hours of programming and 80 hours of testing. The programming would be done by the software vendor under the annual maintenance contract. Testing would be done by department employees and there would be no additional monetary costs.

	FY 2010 Difference	FY 2011 Difference	FY 2012 Difference	FY 2013 Difference
Fiscal Impact:				
Revenues:				
General Fund (01)--Increased Audits	$1,000,000	$500,000	$500,000	$500,000
General Fund (01)--Penalties	$500,000	$500,000	$500,000	$500,000
General Fund (01)--Statutues of Limitation	$615,000	$2,338,000	$2,461,000	$2,461,000
General Fund (01)--95 mill	$0	$1,027,000	$513,000	$0
State Special Revenue (02)--6 mill	$0	$63,000	$32,000	$0
TOTAL Revenues	$2,115,000	$4,428,000	$4,006,000	$3,461,000
Net Impact to Fund Balance (Revenue minus Funding of Expenditures):				
General Fund (01)	$2,115,000	$4,365,000	$3,974,000	$3,461,000
State Special Revenue (02)	$0	$63,000	$32,000	$0

Effect on County or Other Local Revenues or Expenditures:

1. Local taxes paid under protest are deposited in a county property tax protest fund. Taxing jurisdictions may spend funds from this account, but must pay back, with interest, their share of any refunds due the taxpayer.
2. The provisions of Sections 16 through 19 are not expected to change the amount of property tax ultimately paid on centrally assessed property, but they are expected to reduce the amount of taxes paid under protest. This will increase the funds immediately available to local governments and school districts and reduce the risk that local governments and school districts will spend funds that ultimately must be repaid.

Technical Notes:

1. There appears to be a typo in Section 19(2). It is Sections 12 and 13, rather than Sections 13 and 14, that prohibit the introduction of fee appraisals as evidence.

Sponsor's Initials	Date	Budget Director's Initials	Date